WILLDAN GROUP, INC.

Moderator: Tony Rossi
May 4, 2017
4:30 pm CT

Operator: You are placed on hold for today's conference. We are currently checking in additional participants. We do appreciate your patience and please continue to stand by. Your call will begin in just a few moments. Please stand by, your conference is about to begin. Should you need assistance during your call today, please press star then 0.

Good day and welcome to the Willdan Group First Quarter 2017 Conference Call. Today's conference is being recorded. At this time, I'd like to turn the call over to Tony Rossi of Financial Profiles. Please go ahead, sir.

Tony Rossi: Thank you, (Elise). Good afternoon, everyone, and thank you for joining us to discuss Willdan Group's financial results for the first quarter ended March 31, 2017. With us today from management are Chief Executive Officer, Thomas Brisbin, Chief Financial Officer, Stacy McLaughlin, and Mike Bieber, President of Willdan Group. Management will review prepared remarks, and we will then open up the call to your questions.

Statements made in the course of today's conference call, which are not purely historical, are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. The forward-looking statements involve certain risks and uncertainties, and it is important to note that the company's future results could differ materially from those in any such forward-looking statements.

Factors that could cause actual results to differ materially and other risk factors are listed from time to time in the company's SEC reports including, but not limited to, the Form 10-K for the year ended December 30, 2016 and subsequent quarterly reports on Form 10-Q.

The company cautions investors not to place undue reliance on the forward-looking statements made during the course of this conference call. Willdan Group disclaims any obligation and does not undertake to update or revise any forward-looking statements made today.

In addition to GAAP financial results, Willdan also provides non-GAAP financial measures that we believe enhance investors' ability to analyze our business trends and performance. Our non-GAAP measures include revenue, net of subcontractor costs, and EBITDA. We believe revenue net of subcontractor costs allows for an improved measure of the revenue derived from the work performed by our employees.

EBITDA is a supplemental measure of operating performance which removes the impact of certain nonrecurring income and expense items from our operating results. GAAP reconciliations for both of these non-GAAP measures are included at the end of the earnings release we issued today.

With that, I will now turn the call over to Chief Financial Officer, Stacy McLaughlin. Stacy?

Stacy McLaughlin: Thanks, Tony. I'd like to add my welcome to those joining us on today's call. I'll start with an overview of our income statement, then our balance sheet, and finally, our guidance.

Total contract revenue for the first quarter of 2017 increased 102% to $68.4 million from $33.9 million for the first quarter of 2016. Genesys Engineering, the firm we acquired in March 2016, contributed $22 million in contract revenue for the first quarter of 2017.

By segment, including both organic and acquisitive revenue, Energy Efficiency Services increased 164% to $50.1 million, Engineering Services contract revenue increased 27.7% to $14.4 million, revenue from Public Finance Services increased 8.3% to $3.2 million, and Homeland Security Services revenue decreased 9.1% to $623,000 in the quarter.

For the purposes of calculating our organic growth in the quarter, we are including the revenue generated by Genesys Engineering that exceeds the revenue recorded in the same period of the prior year. In the first quarter of 2016, Genesys generated $3.9 million in total contract revenue. The quarter-over-quarter difference of $25.6 million is used for the calculation of our organic growth, which we calculate to be 60% in the first quarter of 2017.

Since the acquisition, we have won joint programs where all of the revenue is being reported under the Genesys legal entity. Thus, the growth in Genesys revenue is reflective of our organic business development efforts and is counted in our organic revenue growth.

Net revenue, defined as contract revenue minus subcontractor services and other direct costs was $28.5 million, an increase of 28.3% from $22.2 million in the year-ago quarter. Direct costs of contract revenue were $50.7 million for the first quarter of 2017, compared with $20.3 million in the same period last year. Genesys Engineering accounted for $16.1 million of the direct costs in the first quarter of 2017.

Excluding the impact of Genesys, the direct costs of contract revenue increased by approximately $14.3 million primarily as a result of the growth in total contract revenue in the Energy Efficiency Services segment and the corresponding increase in subcontractor services and other direct costs. Our direct costs of contract revenue were 74.2% of our total contract revenue in the first quarter of 2017, up from 68.5% in the fourth quarter of 2016.

I will note that subcontractor services and other direct costs were $39.9 million, or 59% of contract revenue in the quarter, up from 34% in the year ago quarter. We expect to see some volatility in these ratios are they byproduct of the mix of project work that we have in any one particular quarter.

General and administrative expenses for the first quarter were $15.7 million compared to $11.8 million for the prior year period. As a percentage of total contract revenue, our G&A expenses were 23%, compared with 34.8% in the first quarter of 2016. The improvement in this ratio was primarily driven by increased efficiencies and greater operating leverage as we scale the company.

G&A grew 33% quarter-over-quarter, while revenue grew 102% over the same time period, indicating that our back-office costs are growing at a far slower rate than revenue. That being said, we are currently seeing an increase in proposal activity for utilities, governments and commercial facilities throughout the country. This is driving higher selling expenses in the near term for programs that would potentially come online in 2018.

Operating income was $2 million for the first quarter of 2017 compared with $1.8 million generated in the fourth quarter of 2016. EBITDA was $3.1 million for the first quarter of 2017 compared with $2.1 million for the first quarter of 2016. EBITDA margin for the first quarter was 4.5%, down from 7.1% in the same period in the prior year primarily due to higher pass-through revenue. As a percentage of our net revenue, our EBITDA margin was 10.8% in the first quarter compared to 10.9% in the same period last year.

We recorded an income tax benefit of $673,000 in the first quarter of 2017 compared income tax expense of $711,000 in the same period last year. The income tax benefit recorded this quarter was the result of tax deductions related to stock option exercises pursuant to the new accounting rules that went into effect for the company in 2016.

We expect our tax rate to increase in the next three quarters to approximately 42%. As a reminder, Congress has not yet reenacted the Energy Tax deductions available through 179D which lowered the company's tax rate in 2016.

Net income for the first quarter of 2017 was $2.6 million, or 30 cents per diluted share, compared to net income of $1.1 million or 13 cents per diluted share for the first quarter of 2016.

Turning to the balance sheet, we had $19.4 million in cash and cash equivalents at March 31, 2017, down from $22.7 million at the end of the prior quarter. The decline was attributable to negative cash flow from operations that we typically experience in the first quarter of each fiscal year due in part to seasonally slower collections at the beginning of the year. Our rapid growth, and the number of new programs we are working on, also played a role in the use of cash in the first quarter.

Consistent with the seasonally slower collections in the first quarter, our DSO increased to 70 days at March 31, up from 65 days at the end of the prior quarter. As of March 31, 2017, we had approximately $1.5 million in borrowings under our revolving line of credit.

Turning to our outlook for the remainder of fiscal 2017, we are increasing our revenue guidance to range from $240 million to $250 million and our diluted earnings per share to range between $1.08 and $1.21.

I'd now like to turn the call over to Tom.

Thomas Brisbin: Okay thanks, Stacy. And good afternoon everyone. As Stacy indicated, we're off to a good start in 2017 and we expect a good year. The results demonstrate that we are in good position for continued growth.

Our pipeline of opportunities is growing and the type of work that we can respond to is diversifying. We are winning and executing new types of work. For example, going way back from 50 years ago we were doing civil engineering for cities in Southern California, eight years ago we started in energy efficiency. Energy efficiency now represents approximately 75% of our revenue. This energy efficiency work, originally auditing type work for Southern California utilities, has now expanded nationwide for over 30 utilities and some 50 different programs.

Through our recent acquisitions, we now provide electrical and mechanical engineering. This allows us to take on a city, university or hospitals' complete engineering requirements as reflected in our announcement on Lawrence, Kansas last quarter.

We can also provide energy savings guarantees to a customer known as performance contracting. We can now handle complex mechanical and electrical systems for any building, campus or community. At (Illinois) a technology, we're just getting started evaluating a campus co-gen facility that may be used as a distributed energy for the IIT campus microgrid, as well as a plant adjacent microgrid. Together, this would constitute a community microgrid.

We were also selected for a California Energy Commission, (CCC) grant for the Air Quality and Management Board campus in Southern California. Again, we'll be looking at energy efficiency, renewals, storage and generation.

Two additional awards for the State of California will have us looking at similar methods to reduce energy consumption for all publicly owned facilities in the state. We are building a company to address the modernization of the grid enabling customers to take more control over their energy requirements.

We are seeking people with the very best expertise to address the energy problems, utilities, commercial, industrial and public sector clients face. Technology is changing rapidly. We want our people to be the most knowledge as we help our customers navigate this changing energy landscape.

Our strategy is to pursue - is to pursue and execute on organic growth first as evidenced by the 60% growth for this quarter. Second, we want to make strategic acquisitions that are synergistic, can grow faster as part of Willdan, and keep Willdan well positioned for the rapidly evolving energy market specifically how we get our electricity and how we use it.

The pace of change will require niche acquisitions with new capabilities to keep Willdan in a leading position. The United States is moving towards using less energy and becoming more energy independent. Customers want to spend less money, have more control and in cases of critical infrastructure be more resilient. Willdan is positioning for this rapidly changing landscape.

Looking ahead, as Stacy indicated, we have increased our financial targets for the year primarily due to our outperformance in the first quarter. Based on the current volume of work and the new programs scheduled to ramp up later this year, we continue to be optimistic about our ability to deliver profitable growth in 2017.

We recently received a notice to proceed on our LCR local capacity requirement contract with San Diego Gas and Electric. We are starting on our first project under this contract in the second quarter which will be a nice incremental addition to 2017 before making a larger contribution next year.

As in Brooklyn Queens where Willdan provided 30 megawatts of targeted load reduction, the utility deferred $1 billion to $2 billion in infrastructure. Energy efficiency is only one type of distributed energy resource. Renewals, battery storage, combined heat and power are coming online throughout the national grid and can be disruptive. Willdan is assisting utilities to overcome this problem.

Finally, I would like to say a couple of things about the shell filing that we did a few weeks ago. While we have no immediate plans to utilize the shelf, it's a valuable tool that we felt we needed to have in place to allow us to be opportunistic in the marketplace. The acquisitions we have made over the past few years have been instrumental in our success in building shareholder value. And having the shelf filing in place will give us the flexibility to continue to use M&A as an important component of our overall growth strategy.

With that, I would now like to turn the call back to the operator for questions.

Operator: Certainly, at this time if you would like to ask a question please press star then 1 on your touch-tone phone. You may withdraw yourself from the question queue at any time by pressing the pound key. Once again, star then 1 if you'd like to ask a question. If you have yourself on mute or speakerphone, please take that off for our system to better recognize your signal. Again, star then 1 if you do have a question.

Our first question comes from Ryan Cassil with Seaport Global. Please go ahead.

Ryan Cassil: Hey, good afternoon.

Stacy McLaughlin: Hi, Ryan.

Ryan Cassil: I guess maybe just like to get an update on any new projects you guys started in the first quarter and, you know, how those are going, you know, just trying to understand the drivers behind the accelerated growth again. And I know there was a couple projects teed up like San Diego Gas and Electric, etcetera, so curious if those have started and how they're going.

Thomas Brisbin: Well I'll add a few and Mike will add a few, the ones I can think of Salt Lake City, (Pacific Corp), Con Edison, multifamily housing, probably Genesys University. I would probably also look at 360. Which one?

Mike Bieber: NCHA.

Thomas Brisbin: NCHA. NCHA, New York City Housing Authority, a lighting contract. Any other significant ones? Those are all pretty significant.

Mike Bieber: 360, Lawrence, Kansas.

(Crosstalk)

Thomas Brisbin: So although we announced those wins probably last year, they're beginning to ramp up.

Ryan Cassil: Okay...

(Crosstalk)

Ryan Cassil: ...SD G&E you didn't mention. Is that one still on the come I guess in terms of ramping up?

Thomas Brisbin: SD G&E I did mention when I said - maybe I didn't mention it clear enough, let me go back. I called it the LCR contract, local capacity requirement. And that one was the one that we announced probably just about a year ago and through negotiations, the announcement said about $90 million award for I think it was six years, five or six years, six years. And our first project is just coming online the second quarter of this year. So that one is just - we signed the contract probably a couple months ago. Maybe this quarter.

Ryan Cassil: Okay.

Thomas Brisbin: ...part of this year. I called it LCR. Oh here it is, yes, we said our LCR, local capacity requirement contract with San Diego Gas and Electric is just getting started. That was that $90 million award.

Ryan Cassil: Okay great. So I mean, I guess your growth rate kind of answers my question here, but any issues sort of ramping up all these new awards all seemingly at the same time, how are you guys, you know, feeling from an infrastructure or capacity standpoint as all this work ramps?

Thomas Brisbin: We're okay right now so I'll say not yet. But Mike, you want to add to that? Mike doesn't want to add to that. Of course they're all difficult ramping up, we're staying on top of it I think better than we were two years ago. Mike's doing a good job making sure that here's no operational issues and that if we're behind on targets we meet with clients and have - make sure we meet them within our first year of ramp up. And as of right now, everything's on schedule.

Ryan Cassil: Okay. Great. And I guess as I look at the guidance, you know, it - you know, I look at the growth rate, sort of the implied growth rate through the end of the year, you know, implies things normalize. You start lapping some tougher comparisons sure, but it seems like the business has so much momentum, is there a bit of conservatism being applied here at this point?

Thomas Brisbin: We're early in the year. We just finished our first quarter, the first quarter was outstanding and we'll see how the year progresses. You know, our projects are subject to both delays and acceleration. So that's how we looked at setting guidance.

Ryan Cassil: Sure. No I appreciate it. And then maybe just could you update us on some of the opportunities that you're seeing out there to the extent you can talk about them? I know Stacy mentioned, you know, an increase in bidding opportunities, you guys have talked about Illinois, you know, sort of pulling, you know, their proposal because they were increasing the scope of it so much it had to be rebid. Could you talk about maybe that one and are there any other new opportunities that have arisen that you might want to share with us?

Thomas Brisbin: Sure, we can go kind of across the country. There's hospitals in Texas, Illinois is still - they haven't decided if they're going to pull back or go forward now with what they have or they might modify so it's still moving forward. The IIT campus one is new, that gets us into the Illinois Commerce Commission approved funding for a microgrid right next to the Illinois Institute of Technology and the co-gen facility we're working on will power potentially both microgrids.

And New York, New Jersey, Massachusetts, all around the Northeast there are additional programs. Con Ed is coming out with new programs. There - what's happening a little bit in the Northeast for Con Ed is like Brooklyn Queens, that's why I mentioned it, they are targeting new load pockets so instead of Brooklyn Queens they're attaching new names to them and they're wanting to know how to reduce the amount of electricity in specific areas.

And that's exactly what San Diego Gas and Electric is - how to reduce load-specific areas. We're also looking at in California, as I mentioned, the CEC grants for their Quality Board, there are other CEC grants coming on microgrids that we're pursuing. We're, for the first time, looking at a federal pursuit. Can't tell you how that'll turn out. That's probably - they usually have long decision times.

What have I missed, Mike, anything?

Mike Bieber: California.

Thomas Brisbin: California, California is still deciding what they want to do. We've heard June, we've heard August for an RFP, we've heard - they want to do something before the end of the year. We are prepared, we're ready. Our programs are still continuing but we are looking forward to the re-compete because, as I said earlier, they're mandated to go from 20% outsourcing to 60%.

Ryan Cassil: Is that...

(Crosstalk)

Thomas Brisbin: So the pipeline's full, I mean, we're writing - I think Stacy alluded to our marketing expenses are up and we - we've got many opportunities, we're not just writing proposals, we're writing proposals we can win. So...

Ryan Cassil: And for California, I mean, is that expected to be split across, you know, multiple players in the market or could you potentially win an out-sized piece of that or all of that? What's the landscape look like on that front?

Thomas Brisbin: We will not win all of that. It'll be split amongst multiple awards and different programs, so you'll look at, you know, residential, commercial, industrial, public sector, you look at ag. They've got about, right now, 120 programs. We think they may consolidate down to 5-10. There's a lot of talk about that because everybody wants to keep what they had. But they are looking at consolidation.

But even if they consolidate there'll be multiple winners in multiple programs, which is fine with us. I mean...

(Crosstalk)

Ryan Cassil: Sure.

Thomas Brisbin: ...it's still going to grow by a factor of three.

Ryan Cassil: Okay great. Thanks for the color. And you mentioned the, you know, the higher subcontractor costs in the quarter, is there a way to think about that in the remainder of the year sort of a target that we could think about?

Mike Bieber: We think it's going to hover around 50/50 for the next two quarters at least. It's tough to see into Q4 and Q1 of next year, but at least for the next couple of quarters probably hang around 50/50. It was up above that at 58% this quarter.

Ryan Cassil: Okay. So normalizes a bit but I think it's still a little up year over year last year. And that's just mix of some of the work you guys have going on right now I presume, is that fair?

Mike Bieber: That's correct.

Ryan Cassil: Okay. I'll jump back into queue. Thanks for taking the questions.

Operator: Thank you. As a reminder, if you do have a question please press star then 1 on your touch-tone phone. Our next question comes from John Quealy with Canaccord Genuity. Please go ahead.

John Quealy: Hey, good afternoon, folks. First question, in terms of the $240 million to $250 million guide on the top line, can you just remind us in terms of visibility what's contract and awarded in that number?

Mike Bieber: Practically all of it. Yes.

John Quealy: Okay. In terms of the cash flow profile, so Q1 obviously, you know, doing a lot of work and using some cash. Talk about the cash flow cadence, if you will, moving through the rest of the year with seasonality and then a follow on to that, folks, is dry powder, what are you thinking of with the cash on hand plus what you'll generate in obviously that you have available to draw down in terms of M&A potential?

Stacy McLaughlin: For cash flow operations we've typically in the first quarter, as I mentioned, have a used-in position just with the holidays and the increase in amount of work, additionally we have an increase in AR and our costs in excess of billings, which helped kind of bring that down. As we progress throughout the year, we go back into a positive operating situation with our cash. And that's been the case for the past I think I have here, four years.

John Quealy: Yes, and Stacy, any estimate or guestimate on, you know, CFO for the full year and, I mean, last year it was about 22-ish or something like that. And then what sort of dry powder are you thinking about in terms of size of M&A and you look at that pipeline?

Thomas Brisbin: John, we haven't guided on free cash flow for the year, but it should be good, you know, we're looking for, you know, cash flow that's similar to last year. We've got about $20 million in the bank right now and we've got $35 million in borrowing capacity without expanding plus another 25% in the accordion. We need it because we're $25 billion in the accordion. We need it, we're looking at a number of M&A opportunities right now, and so it's likely that over, you know, the next sort of period of time we'll start to run into a net debt position as we make acquisitions and use our credit facility.

John Quealy: Yes, okay. That's helpful. And then just lastly in terms of - thanks for all the detail on the pipeline and the potential target business, talk about are you seeing any major pressures on wage inflation or subcontractor availability? Talk about, as you're expanding especially in energy filling out those relationships with subcons and how that's working for you. Thanks, folks.

Mike Bieber: Wages are going up, not as fast as revenue but wages are going up and we're able thus far to pass those along to our clients. Sometimes there is a delay in that in that you might sign a one-year contract where you can't escalate until, you know, a certain period within a given contract year. But we're able to pass on the escalated wage costs in our contracts.

In terms of subcontractors, we are using those quite a bit as we ramp up these large contracts that Tom mentioned. We're relying heavily on subcontractors to allow us to ramp that quickly. In future years or periods, we may be able to pull some of that work in house once we get to a more steady run rate on some of the new contracts.

Operator: Thank you. It appears we have no further questions at this time. I'll turn it back to management for any additional or closing remarks.

Thomas Brisbin: Okay. I'd like to thank all of you for participating on our call today and for your continued interest in Willdan. Have a great day.

Mike Bieber: Thank you.

Operator: That concludes today's conference. We appreciate your participation. You may disconnect at any time and have a great day. Again, today's conference has concluded. We do appreciate your participation. You may now disconnect. Have a great day.

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